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Pension surplus to lift earnings

By Barry B. Burr

A $300 billion surge in the surplus assets of corporate pension funds in the first half of 1987, should translate into a 6% to 8% increase in corporate earnings.

The surge in the surplus resulted when the the value of assets increased by $200 billion while liabilities fell by $100 billion, according to Robert D. Arnott, vice president and equity strategist at Salomon Brothers Inc., who produced the estimates.

"Nobody is factoring that into earnings" estimates, Mr. Arnott said. "This growth in pension surplus and its effect on corporate profitability reinforces one view that a market top is not likely to occur before early 1988," Mr. Arnott notes in a research report.

The longer term impact of the huge surplus is more difficult to estimate, especially as two other new studies have thrown doubt on the long-term stability of the pension surplus and have overturned the long-held, comforting perception of a steady growth of excess pension funding.

The studies by executives of Salomon Brothers and Morgan Stanley & Co. show that only after the second quarter of this year has corporate pension surplus reached a level similar to that of the early part of the decade.

As Mr. Arnott points out, "Reduced pension contributions and larger surpluses should mean that net selling of stocks by pension sponsors will con-

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Pensions & Investment Age

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Investors cool to LDC debt

By Marcia Parker

NEW YORK — Institutional investors are wary of efforts to involve them in the solution of the Third World debt crisis.

Wall Street investment bankers are counting on the institutions to snap up Third World debt once they fashion the products to make the investment feasible, but a survey of more than 30 institutional investors, including corporate and public pension fund officials, global money managers, insurance company executives and high-yield bond managers, found little enthusiasm and lots of skepticism about Third World debt investments.

Across the board, investors expressed strong skepticism of what they view as "extremely risky" and "inappropriate" investments for themselves and their clients.

They cited a litany of worries about Third World debt investments, and indicated their concerns were so keen they would not feel comfortable investing corporate, public or client money.

While most investors said they were intrigued intellectually by the idea and would take a look at Third World debt as they would any new investment, their immediate reaction is "hands off."

"There's been a lot of talk about what it would take to get us (institutional investors) interested," said Charles H. Salisbury Jr., vice president and director at T. Rowe Price Associates, Baltimore, which has more than $20 billion in assets under management. "Here's what we think: It's going to be a tough sell."

"It's a scary thing. Nobody wants it," said David Seidel, vice president-pension fund management at GTE Investment Management Corp., Stamford, Conn., which runs the $10 billion GTE Corp. pension fund.

"It's killing the banks. Those countries have too much debt and they can't afford to pay it. How can anyone guarantee it? How can they fashion an instrument to eliminate the risks in Third World debt?" Mr. Seidel said, summing up the views of many investors.

Jim Sullivan, president of Sullivan Money Management, a Houston-based high-yield bond

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Investing in the debt of Third World countries and economic centers like Mexico City, above, is drawing only skepticism from the ranks of American institutional investors.

Inside:

SOUTH AFRICA: Mount Holyoke College's endowment is among the funds using investment clout to battle apartheid. A look at the status of the divestiture movement — Page 35.

Proposed funding change could flow to bottom line

By Nicky Robertshaw

WASHINGTON — Corporate pension contributions could be whipsawed year to year under a revenue-raising option expected to be taken up by the House Ways and Means Committee, possibly this week.

Such whipsawing of pension contributions, in turn, could cause dramatic swings in corporate earnings.

The panel is trying to drum up $12 billion in revenue for next year as it struggles to comply with the Gramm-Rudman-Hollings Act's deficit reduction targets.

The pension proposal would tax contributions made to defined benefit pension plans that already are funded by 150% or more of termination liability, under a proposed redefinition of full funding.

The current full funding standard is 100% of accrued and future liabilities, which includes all benefits projected to accrue until employees reach retirement age as well as projected salary increases. Contributions beyond the full funding limitation are subject to a 10% excise tax.

If 110% of termination liability becomes the minimum funding standard — as is proposed by the Reagan administration — and 150% of termination liabilities becomes the maximum, employers would have a relatively narrow range to hit each year, pension experts pointed out.

"I think there is potential for cutting down the flexibility too much," said Ethan E. Kra, principal and actuary for William M. Mercer-Meidinger-Hansen Inc., New York. "Budgeting cash flow could become a real problem," he added, pointing out a primary reason for current pension surpluses is the bull market.

"You might be OK at the beginning of the year and not be OK by the end of the year," Mr. Kra said, noting the employer could have problems whether the market went up or down. He cited one employer portfolio that this year experienced a 40% increase between Jan. 1 and Aug. 31.

A plan that had been 110% funded at the beginning of the year on a termination basis now would be 156% funded because of the market. Barring any market downturn by the end of the year, a contribution made for that plan year would be taxable.

On the other hand, a repeat of the 1973-'74 market drop — when the stock market lost 50% of its value — could cause a plan funded at a 150% level to decline to, say, a 90% funding level, meaning the company would have to come up with a large contribution.

"Companies will get into a situation where they are be-

Continued on page 53

Seix leading shake-up as MacKay CEO

By Marlene Givant

NEW YORK — After years of poor equity performance, losses of equity clients and personnel changes, MacKay-Shields Financial Corp. has decided to overhaul its equity department.

To execute the changes, Christina Seix, former president of the firm and head of its high-performing bond department, has been promoted to chairman and chief executive officer, replacing William R. Grant, who has been named chairman of a new international subsidiary of New York Life Insurance Co., the investment firm's parent company.

MacKay-Shields, which manages $5.5 billion about evenly split between equities and fixed income, will undergo a major equity restructuring to get that department up to speed with the top-notch fixed-income department Ms. Seix will continue to lead.

However, there will be no change in MacKay-Shields basic equity investment approach, which is growth-oriented. It will continue to offer value investing and indexing as options.

As part of the changes, four individuals have resigned or soon will leave the equity department. Bill Feick Jr., managing director and senior investment manager, and James Cowperthwait, who also was a managing director, have joined other firms. William H. Todd, managing director-equities, will leave to join another firm by year end. And John McNamara, a research analyst, will leave the firm shortly but his plans are not known.

The aim is to keep a core of equity investment professionals and hire additional staff, Ms. Seix said. She added the departing staff members in recent years had assumed more service- than investment-oriented responsibilities. The firm has 11 equity portfolio managers.

In addition to implementing sweeping changes, Ms. Seix will pioneer a position held by few women. Pointing out the business is dominated by men, Mr. Cowperthwait said, "I can't think of a major firm that has had a woman in charge ever, especially one who's 37 years old."

"She has a very risk-averse bond policy aimed at positive real returns every quarter. She's brought in a lot of business and packs a lot of power at that firm," he added.

The streamlining of staff will aid in the firm's revamping, according to the new chairman.

"Basically, the chronology of events is we've had a lot of growth in fixed income and not as much on the equity side," Ms. Seix said. "The reason is not investment skills at all; we have some of the smartest stock pickers in the business. But we need a fine-tuning in terms of (investment) disciplines and a more defined investment process."

Clients contacted by *Pensions & Investment Age* were confident of Ms. Seix's abilities.

The $800 million pension fund of Dana Corp., Toledo, Ohio, which has had a "substantial size" equity account with MacKay-Shields for five years, has been satisfied with the firm's performance and expects little impact from the changes.

"The implications of the departures aren't evident until time has passed," said Ralph Lipford, vice president-investment management. "The individuals we deal with have not departed . . . I don't really view those results as significant."

Fieldcrest Mills Inc., Eden, N.C., has had $5 million in equities of its $10 million supplemental retirement plan with MacKay-Shields for at least 10 years. The company has total retirement assets of $175 million.

"We think it will have very little effect. We've been with them 10 years through various (person-

Continued on page 54

GTE loses Seidel to manager

David Seidel is becoming president and chief operating officer of Management Asset Corp.

David A. Seidel, vice president of pension fund management for GTE Investment Management Corp., Stamford, Conn., is leaving to become president and chief operating officer of Management Asset Corp., a Westport, Conn., money management firm with more than $900 million in assets.

Mr. Seidel, who has been at GTE for more than two years, will take over day-to-day operations at Management Asset Oct. 19. Those duties were handled by Leonard Heine, Management Asset's chairman and chief executive officer. Mr. Heine will concentrate on broader complex strategies of financial investments.

Messrs. Seidel and Heine confirmed the move, but would not comment further. John Carroll, president of GTE Investment Management, said he would fill the position as soon as possible; he also declined to comment further.

Mr. Seidel's move comes shortly after GTE Investment Management, which runs the $10 billion GTE Corp. pension fund, realigned its equity management structure.

Under the new system, responsibility for traditional and non-traditional external managers was changed and internal equity management responsibilities were broadened, giving more individuals more varied duties (*Pensions & Investment Age*, Sept. 7). Mr. Seidel still headed equity and non-traditional investments. ■

LTV dispute spurs review of plan to boost premium

By Nicky Robertshaw

WASHINGTON — Congressional proposals for pension insurance premiums may be trimmed sharply if the Pension Benefit Guaranty Corp. wins the first round in court on restoration of three pension plans to The LTV Corp.

The absence of a premium in a Senate Labor and Human Resources Committee draft proposal aimed at shoring up the struggling agency sparked rumors the Congressional Budget Office may be revising its estimate of the amount of revenue needed to be raised in the budget from the pensions area.

Capitol Hill and Reagan administration sources suggested the budget office may be changing its figures in light of the PBGC's Sept. 22 move to return three terminated plans to Dallas-based LTV. If the restoration sticks, it would cut the agency's $4 billion unfunded liability in half (*see story, Page 21*).

"We're still doing estimates in the same manner as before, but we're waiting to see what happens in court," a budget office source said. He added the office is preparing revised figures in case the PBGC wins the first round. Requests for revised figures were made by all four congressional committees that have or will have proposals dealing with the pension issue.

If the PBGC's unfunded liability is reduced, a smaller premium would be needed to come up with the same amount of federal revenue.

It is a policy decision, however, as to whether the premium would be reduced or the amount of revenue would be increased.

The congressional tax-writing committees are looking for $500 million in revenue from the pensions area for the next three fiscal years. Under a Ways and Means Committee proposal, for example, $1 billion in increased premiums would be offset by $500 million in money "lost" because of new minimum funding standards and reduced transfers from the PBGC trust fund.

The Congressional Budget Office source pointed out reducing the PBGC's unfunded liability postpones the need for a higher premium, but not for long.

When the PBGC moved to restore the three LTV plans, Executive Director Kathleen P. Utgoff stressed it would not solve the agency's problems. "The need to reform pension funding, to improve the PBGC's premium income and to address treatment of its claims in bankruptcy court has not changed," she said.

The agency charges an annual premium of $8.50 per participant, which had been more than tripled from $2.60 just last year.

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Trustees of two plans of the International Organization of Masters, Mates and Pilots union, whose members work as deck officers on ships such as the one above, won one suit but still face others.

Court backs union claim

By Joel Chernoff

NEW YORK — Two maritime union retirement plans lost $34.1 million from the investments of a money management firm that channeled plan assets into speculative start-up companies, according to a federal magistrate.

While the trustees of the two International Organization of Masters, Mates and Pilots plans recently won both an appeals court victory and the hefty damages recommendation against their former manager, they still are at sea: They face lawsuits from plan participants and the Department of Labor over their role in the investment of $31.5 million in assets.

One of the major issues is whether the manager, New York-based Tower Asset Management Inc., acted at the direction of plan trustees in investing substantial amounts into maritime-industry start-up companies with the aim of creating new jobs for union members.

While court battles likely will go on for years, the investments appear to have the hallmarks of a social investing scheme gone awry.

Robert Hayes, union vice president-Atlantic ports, said, "My personal theory is the president of the union (Capt. Robert Lowen) was interested in improving membership during the worst period (in the maritime industry) since the Great Depression," he said. "My personal hunch is he was duped."

But another union source denied the investments were targeted

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'Quant' norm hard to find

By Barry B. Burr

Investment returns, turnover and price of brokerage commissions vary widely among quantitative equity managers, a *Pensions & Investment Age* survey shows.

The telephone survey focused only on assets 16 quantitative managers run for tax-exempt clients in unhedged portfolios containing domestic and generally larger-capitalization stocks.

The results show the managers, by and large, have outperformed the Standard & Poor's 500 stock index over the years.

Returns for any one year, however, vary widely among managers.

The year ended June 30 was tough on most managers' performance, with only three bettering the S&P 500's return of 25.2%. Returns ranged from 11.1% for Denver Investment Advisors Inc., Denver, to 29.9% for Disciplined Investment Advisors Inc., Evanston, Ill.

By contrast, all but one manager outperformed the index's 35.9% return for the 12 months ended June 30, 1986. Even then, returns varied, ranging from 21.5% for Trinity Investment Management Corp., Boston, to 51.8% for Advanced Investment Management Inc., Pittsburgh.

For the 12 months ended June 30, 1985, only 12 of the 16 managers surveyed were running money in the quant strategy; and of those managers, two-thirds bettered the market. For the five years ended June 30, five of the six managers running money in business that long beat the S&P.

Portfolio turnover ranged widely among the managers. In the 12 months ended June 30, the average trading ranged from 35% by Gradison & Co., Cincinnati, to 125%-150% by Denver Investment Advisors.

The average price paid per share in brokerage commissions ranged from 2.6 cents by Aronson & Fogler Investment Management, Philadelphia, to 9 cents by Gradison. The average of the 15 managers reporting costs is nearly 5.5 cents per share.

Steven Pisarkiewicz, vice president and senior consultant at SEI Corp., New York, said the equity managers paid 7.05 cents to 7.1 cents on average in the 12 months ended June 30. In the second quarter alone, he said the price dropped to 6.98 cents.

In interviews, some managers, pension executives and consultants said per-share commissions for quantitative managers should be lower than for typical equity managers because of the nature of the investment strategy.

But Mr. Pisarkiewicz disagreed. "My experience doesn't point me to any direct relationship" between equity investment style and brokerage commissions per share.

"The cost of commissions tends to be a function of the relationship of a money manager and his brokers," Mr. Pisarkiewicz said. "A money manager negotiates with a broker. It's like any business relationship. If you put through a lot of business, you probably would be able to negotiate a lower rate."

> "I would expect quant managers to trade for below average (in terms of cost of commissions per share), because they don't get the benefit of research."
>
> **Gerald J. Paolini**
> **Xerox Corp.**

He said commissions were only part of the cost of trading stock. An important part of the cost also is execution impact, he added.

At Rosenberg Institutional Equity Management, Marlis S.S. Fritz, director-marketing, said its commission average of 5 cents a share "isn't particularly low. We don't care about paying low commission costs. We don't want to nickel-and-dime brokers. We're more concerned about market impact (trading execution) than commission costs."

SEI has no breakdown of the price per share quantitative managers pay. SEI's aggregate commissions statistics comes from its plan sponsor data base, containing 600 equity portfolios of about $90 billion, run by some 250 different managers.

Mr. Pisarkiewicz said SEI is planning to break down data from its stock trading research by investment style to see if there is any correlation with the price each manager type pays per share. He expects SEI to have such a breakdown available next year or in 1989.

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Ceco Industries Inc., which erected the addition to this Texas hospital, plans to use surplus pension assets to pay down $108.5 million in debt incurred as a result of a leveraged buy-out when senior management took the company private in 1986.

Ceco reversion to aid debt load

By Marlene Givant

OAK BROOK, Ill. — Ceco Industries Inc. will terminate its $90 million overfunded salaried defined benefit plan and use the asset reversion to pay down debt it assumed when it was taken private in a leveraged buy-out late last year.

After the termination, the company will form a new, uncommon account-based defined benefit plan, purchasing annuities to satisfy benefit obligations.

The asset reversion is expected to allow the corporation to pay down the $108.5 million in senior bank debt assumed when it was taken private by senior management in December 1986. The amount of reversion, however, is undetermined.

As of July 31, 1986, the salaried plan had an estimated surplus of $18.2 million on a pre-tax basis. During the 12 months following the leveraged buy-out, the company expects there will be approximately $15 million of excess assets before taxes and $7 million of excess assets on an after-tax basis.

Because the amount of surplus depends on such factors as the timing of the reversion, performance of the salaried plan's investment portfolio and the actuarial assumptions for the computation of benefits at the time of the termination, "there can be no assurance that excess funds will be available to reduce the senior bank debt," according to the prospectus on the leveraged buy-out.

The company expects to file for the termination with the Pension Benefit Guaranty Corp. in the next week or two. The actual reversion will take place in early 1988.

"There was a sizable surplus in the plan and the company went through a leveraged buy-out. The surplus, once recaptured, will be used to pay down corporate debt," said Stanley Rohwedel, manager of corporate finance.

Ceco has purchased non-participating single-premium group annuity contracts for participants in the terminated plan.

To help fund the purchase of the annuities, equity managers Sanford C. Bernstein & Co. Inc. and MacKay-Shields Financial Corp., both of New York, were terminated. Mr. Rohwedel could not provide the size of each account because assets frequently were switched among equity accounts. But he said the fund had about $60 million in equities in early 1987; now it has none.

Ceco will retain Chase Investors Management Corp., New York, which has managed an immunized bond portfolio since 1984. The size of that account was not available "because we're in the midst of selling off bonds to pay for the annuities," he said.

It also will retain Dimensional Fund Advisors, Santa Monica, Calif., but will switch the firm's $12 million equity account to a fixed-income account.

So far, the plan has purchased $45 million in annuities including $35 million from New York

Continued on page 51

First Boston lead underwriter in quarter

Total underwritten offerings - 3rd qtr.*

Firm	$ mils.	Market share
First Boston (5)	10,624.4	15.2
Salomon Brothers (1)	10,047.3	14.3
Morgan Stanley (3)	9,684.8	13.8
Merrill Lynch (4)	8,578.2	12.1
Drexel Burnham (7)	7,041.2	10.1
Goldman, Sachs (2)	6,045.9	8.5
Shearson Lehman (6)	5,788.7	8.3
Prudential-Bache (12)	1,826.4	2.6
Kidder, Peabody (8)	1,439.1	2.1
PaineWebber (20)	1,402.5	2

Total debt offerings - 3rd qtr.*

Firm	$ mils.	Market share
First Boston (4)	9,066.5	16
Salomon Brothers (1)	8,703.9	15.4
Morgan Stanley (2)	8,153.8	14.4
Merrill Lynch (3)	6,892	12.1
Drexel Burnham (6)	6,073.2	10.7
Shearson Lehman (7)	5,330.5	9.4
Goldman, Sachs (5)	4,777.3	8.3
Prudential-Bache (11)	1,126.9	2
Kidder, Peabody (8)	938.4	1.7
Smith Barney (15)	902.5	1.6

Total equity offerings - 3rd qtr.*

Firm	$ mils.	Market share
Merrill Lynch (5)	1,686.3	12.5
First Boston (4)	1,557.9	11.6
Morgan Stanley (6)	1,530.9	11.4
Salomon Brothers (8)	1,343.5	10
Goldman, Sachs (2)	1,268.6	9.4
Drexel Burnham (10)	968	7.2
Prudential-Bache (16)	699.5	5.2
PaineWebber (13)	677.5	5
Kidder, Peabody (7)	500.8	3.7
Dean Witter (11)	495.8	3.7

* Full credit to lead manager
Numbers in parentheses indicate the firm's second-quarter 1987 ranking
Source: IDD Information Services Inc., New York

By Brad Rudin

NEW YORK — First Boston Corp. pushed past Salomon Brothers Inc. to emerge as the top-ranked underwriter of taxable securities in the third quarter.

Salomon, however, remained No. 1 in underwritings completed during the first nine months of the year, according to IDD Information Services Inc., New York.

Total taxable third-quarter underwriting volume rose 6% to $70.23 billion from $66.14 billion in the second quarter. Debt volume increased to $56.76 billion from $49.4 billion, a gain of 15%, while equity volume sank 19% to $13.47 billion from $16.74 billion.

Debt volume, buoyed by the strong economy, contended with

Continued on page 53

Citicorp action may spark others

By Brad Rudin

NEW YORK — Rising interest rates and robust stock market gains make it likely increasing numbers of corporations will follow Citicorp in settling a portion of their pension obligations with the purchase of annuity contracts.

Relying on a pension accounting rule, Citicorp settled part of its approximately $1 billion pension obligation by buying a $400 million annuity from Metropolitan Life Insurance Co., New York. The plan has assets of about $1.5 billion.

The annuity purchase added $1 a share to third-quarter earnings and boosted shareholders' equity.

Citicorp announced the annuity purchase Sept. 24, a week after raising $1.1 billion in a public stock offering. Both moves were taken to repair the balance sheet damage that resulted from the corporation's decision in May to boost its loan-loss reserve $3 billion. The special provision brought to $4.9 billion the amount reserved for potential loan losses.

Several Citicorp competitors later announced similar moves, making some of them candidates for annuity purchases, including Chase Manhattan Bank, Chemical Bank and Bankers Trust Co, all of New York.

Interest in annuities is expected to increase along with interest rates. When interest rates rise, corporations are able to purchase annuities more cheaply. The decision to buy an annuity becomes still more attractive when a pension surplus swollen by stock market gains can be converted into higher current earnings through the use of the settlement rule established by Financial Accounting Standards Board Statement 88.

The pension accounting rule allows the immediate recognition of a deferred gain or loss.

Citicorp's announcement of the annuity purchase could be the start of a revival of this practice, said James P. Klein, a vice president at Towers, Perrin, Forster & Crosby, a New York-based actuarial and consulting firm.

CITICORP

"You can start to sense it when people are finding the annuity purchase rate to be pretty good. I haven't really seen it yet. Citicorp is the first one," Mr. Klein said. "A couple more points and people will start looking at it and say 'not a bad deal.' "

Rising interest rates have boosted the annuity business at Metropolitan, said Anthony Amodeo, an actuary for the insurance company. The internal rate of return of annuities is well above Treasuries, Mr. Amodeo said, declining to give additional information about rates.

The incentive to record an earnings gain from the settlement of pension obligations seems particularly powerful for money-center banks, which have been plagued by problem loans to developing countries.

Because earnings and the capital base have been under pressure, bankers have been trying to realize gain from undervalued assets, said Paul H. Baastad, an analyst at S.G. Warburg & Co., San Francisco.

"It seems likely that other money-center banks with overfunded pensions would certainly think seriously about using (the pension plan) as a source for strengthening their capital base," he said.

"It's very hard to say," said Andrew M. Aran, an analyst at Standard & Poor's Corp. "I'm sure they are all considering it."

Executives at other money-center banks, however, declined to say whether they would buy annuities.

Manufacturers Hanover Corp. benefited from FASB 88 in 1986 and 1985 when it recognized gains of $18.7 million and $53.5 million, respectively, as a result of its settlement of pension obligations with annuity purchases.

"It's not a new idea and not unanticipated," said Jeremy Gold, a principal with the pension group at Morgan Stanley & Co. "We advise banking clients to consider (settlement) as one source of equity capital."

The settlement of part of its pension obligation will enable Citicorp to record a $160 million after-tax gain in the third quarter. On a pre-tax basis, the gain is $300 million.

FASB 88 "creates a major opportunity for companies with substantially overfunded plans, because overfunding at the date of compliance with FASB 87 is treated as an actuarial gain," according to a recent Salomon Brothers Inc. publication. Under Statement 87, actuarial gains and losses are normally deferred and amortized over the average service period of employees.

"By purchasing annuities for some or all of their obligations, these companies can bring into current earnings the gains that would otherwise have been recognized only over an extended period of time," according to the Salomon report.

As a result of the charge against earnings, Citicorp reported a $2.3 billion loss for the first six months ended June 30, 1987, or negative $17.12 a share, on revenue of $5.7 billion.

Without the charge and related tax benefits, the bank would have earned $552 million, or $3.59 a share, in the first half of 1987.

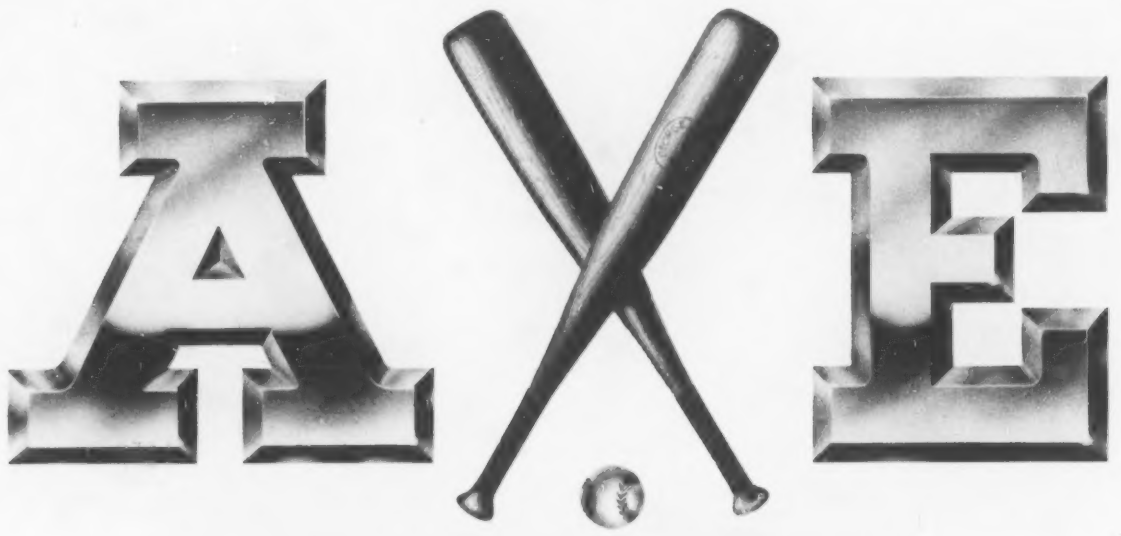
The bank earned $505 million, $3.47 a share, on revenue of $4.9 billion in the first half of 1986. ■

Corrections & clarifications

• A profile of **Crestar Bank**, Richmond, Va., should have been included in the Sept. 7 master trust directory. The bank, with $151 million in master trust assets for nine clients and $5.7 billion in master custodial assets for 191 clients as of June 30, would have ranked 24th.

• Equity managers in **Evaluation Associates Inc.**'s universe posted first-quartile returns of 27.3% for the half, median returns of 23.8% and third quartile returns of 21.2%. Balanced managers in EAI's first quartile had returns of 2.2% in the second quarter and 16.4% for the half. The figures were reported incorrectly in the Sept. 21 issue.

• **Wachovia Bank & Trust Co.** is handling fixed-income investment for the Wake County Hospital System and **Wedge Capital Management Inc.** is handling part of the system's equity investments. The investment type each is handling was switched in the Sept. 21 issue.



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Corporate Finance

Stanley Works, which offers a wide variety of tools for both "do-it-yourselfers" and professionals, now has settled into integrating the businesses it acquired in the past few years.

Stanley Works slows buzz-saw acquisition pace

By Marcia Parker

NEW BRITAIN, Conn. — The Stanley Works is taking a breather after a two-year acquisition binge of 14 businesses and a restructuring effort that has reshaped the well-known maker of hand tools into a major consumer and industrial products company with a growing presence overseas.

"This year we're settling things down, integrating the businesses we've acquired," Richard H. Ayers, Stanley president and chief operating officer, said during a break in a recent conference on corporate restructuring in New York.

In the past few years, Stanley has sharpened its focus in two areas: supplying products and services to do-it-yourselfers and supplying professionals with tools and other quality specialty products.

The three-pronged strategy involving acquisitions, divestitures and cost-cutting has essentially been completed. A key element has been to meet low-cost foreign competitors head-on by setting up manufacturing facilities overseas and marketing products in many countries.

Fourteen acquisitions — including seven in 1986 and two in 1987 — have been in the core business lines where Stanley is market leader or No. 2. Most were paid for with internal cash flow, and the rest came from increased borrowings, according to R. Alan Hunter, vice president-finance and chief financial officer.

The acquired businesses — including the Bostitch fastening tool and fastener business Stanley bought from Textron Inc. and the hand tool business of the Peugeot group of France — are already contributing to the Stanley bottom line. The businesses are relatively free from low-cost foreign competition, which has been a troublesome matter for Stanley and its other American competitors.

"We are starting to use some of our overseas facilities to source some goods for the U.S. and that helps us compete," Mr. Hunter said. "The change in currency (softening of the dollar makes U.S. exports more attractive) has also helped."

Stanley has manufacturing sites in Taiwan, Brazil and Mexico.

Continued on page 18

Investment banks retain dominance

By Brad Rudin

NEW YORK — Commercial banks took eight of the top 20 places in the private placement league tables for the first half of 1987, two more than in 1986, according to data compiled by IDD Information Services Inc.

That gain overall was somewhat offset by the commercial banks' loss of one place — down to two — in the top 10.

Although the private placement market continues to be dominated by debt offerings, equity-linked deals have shown some growth, said Marc Dash, head of the private placements group at Goldman, Sachs & Co., New York. Debt with warrants in the high-yield market have gained acceptance because the equity link provides an added incentive to investors, but equity deals account for a small proportion of total volume because they come in much smaller sizes than debt transactions, he said.

Chemical Bank, New York, and Security Pacific National Bank, Los Angeles, made their way to the the top 20 in the first half of 1987. They were not on last year's list.

Three New York-based investment banks — Bear, Stearns & Co., Dean Witter Reynolds Inc., and Lazard Freres & Co. — disappeared from the top 20 after making it to the upper end of IDD's private placement league tables last year.

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Securitized loans attracting ESOPs

By Brad Rudin

NEW YORK — A growing number of ESOP sponsors, attracted by lower borrowing costs, are financing their employee stock ownership plans with securitized loans rather than conventional term debt.

In addition, securitized ESOP loans — now being marketed aggressively by several money-center banks — could boost the number of companies sponsoring ESOPs because the loans maximize the tax advantages available to the companies.

Securitized ESOP loans are floating-rate notes sold to investors who qualify for the 50% interest income exclusion established by Congress in 1984. Banks, thrifts, savings and loan associations, insurance companies, mutual funds, finance companies and the domestic finance subsidiaries of foreign banks qualify for the exclusion under the Internal Revenue Code.

Like the standard ESOP term loan, proceeds from the sale of the ESOP notes are used to buy employer stock. From the plan sponsor's view, the primary difference between the ESOP term loan and the ESOP note is the price.

"You're talking about saving some 40 basis points off commercial paper with a traditional loan, if you structure it as a (securitized loan) you should almost double those savings," said Patricia A. Lynott, vice president in the ESOP financing unit of Chase Manhattan Bank, New York.

While an ESOP term loan carries a coupon between 80% and 85% of prime, the securitized ESOP loan would be priced about 75% of prime, said Kim M. Chandler, vice president at Bankers Trust Co., New York, a leader in the securitization of ESOP loans.

Because of their lower rates, securitized ESOP loans have potential as a refinancing vehicle for companies that have financed employee stock ownership plans with more expensive term loans.

For example, in August, Duff & Phelps Inc., Chicago, refinanced its 2-year-old ESOP with a $34 million securitized ESOP loan. "We're looking forward to interest savings as a result," said Karen W. Brown, a vice president at the financial services firm.

Corporate interest in securitized ESOP notes is likely to grow as interest rates rise, said James H. Zukin, a partner with Houlihan, Lokey, Howard & Zukin Inc., Los Angeles, a national valuation advisory firm.

"So far, the major banks in this field have been developing ESOP financing vehicles in a laboratory environment," said Mr. Zukin, referring to the relatively small size of securitized ESOP loans and the companies that have used them as a financing vehicle. The average size of the five securitized ESOP loans done to date is slightly less than $23 million.

"If and when they take it to the megamerger ESOP marketplace, then it should have a profound effect. Assuming a 2% saving, (securitization) eliminates the need for significant equity relative to a non-ESOP (leveraged buy-out) bidder," he said.

Strong demand for low-cost capital and a healthy investor appetite for tax-advantaged securities mean a bright future for securitized ESOP loans, said Ms. Chandler.

Bankers Trust, which has sold $65.5 million of securitized ESOP loans to date, expects its volume will reach $500 million by November. "We're expecting a couple of billion dollars by the end of 1988," Ms. Chandler said.

"If you feel that the trend toward employee ownership will continue or increase, then I think you have to believe that a securities market for this type of financing will develop," said Kenneth Winslow, a vice president at Chemical Bank, New York.

Chemical, which has not sold any securitized ESOP loans, is working on a second-generation product that will allow a deeper market than now exists, Mr. Winslow said.

Dividing the securitized ESOP loans into securities for the taxable and tax-exempt market is one possibility Chemical is considering. Pooling and packaging of several ESOP loans into a note that resembles a security based on lease receivables is also under consideration, he said.

The flow of tax-advantaged capital into ESOPs gives management a low-cost means of financing leveraged buy-outs, putting stock into friendly hands and financing acquisitions, Ms. Chandler said. "ESOP debt is at the heart of what's going on in corporate finance today," she said.

The advantages inherent in securitized ESOP loans build on the deductibility of principal and interest payments that are made to repay the loan to the plan. Corporations favorably regard this tax treatment because ordinarily only interest payments are deductible.

Securitized ESOP loans offer intermediate-term financing with notes that float on the short end of the yield curve because they can be put back to the plan sponsor at par after a short period, typically seven or 30 days. The notes are repriced on a schedule that coincides with the put periods.

Because investors look at the notes as short-term investments, they demand a rate that is lower than what would be required by the security's intermediate-term maturity.

If the remarketing agent fails to sell the notes that are put to the plan sponsor, those securities are bought by the bank providing a letter of credit. That bank, in turn, would seek reimbursement from the plan sponsor at the end of the financing period.

In cases in which the ESOP notes are sold without credit enhancement, the investors would present a direct claim against the plan sponsor if the remarketing failed.

A failed remarketing would not create a solvency issue for the plan sponsor in a deal without credit enhancement because the size of the loan would be small relative to the borrower's capitalization and ability to buy back the notes, said Ms. Lynott.

Bankers Trust calls its securitized ESOP loan a FRESOP, or floating-rate employee stock ownership plan. At Chase, the product is called TREND, for tailored-rate ESOP notes on demand. Manufacturers Hanover Trust Co., New York, refers to its product simply as ESOP notes.

"It's a marketing pitch," said one official at a bank that does not offer securitized ESOP loans. "It adds to the cachet of the bank that has them, but because they

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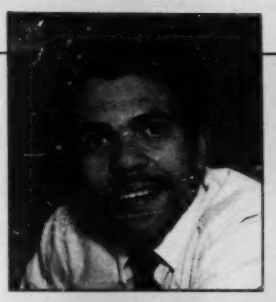


From top: Kenneth Winslow, vice president at Chemical Bank; Patricia Lynott, vice president at Chase Manhattan Bank; Kim Chandler, vice president at Bankers Trust Co.; and James Zukin, partner at Houlihan, Lokey, Howard & Zukin.

Banks . . .

Continued from page 17

Although the investment banks are facing more competition in the private placement business, they still have a solid grip on the top of the league tables.

Goldman, Sachs & Co., Salomon Brothers Inc., and Merrill Lynch & Co., all of New York, took the top three places in the league table for the first half of 1987.

Goldman, which took the top spot in overall private placement volume last year, owes its strong first-half showing this year to the diversity of its private placement business, said Mr. Dash. Goldman survived a decline in its leveraged buy-out business "because other areas continue to be very strong for us," Mr. Dash said. Traditional private placements as well as transactions relating to leveraged leasing and project finance contributed to Goldman's showing.

Goldman also took first place in the private placement of mortgage-related private placements. First Boston Corp. and Citicorp, both of New York, took the next two places. Salomon Brothers, First Boston and Citicorp took the first three places last year.

The top spot in lease-related private placements in the first half was held by Goldman, followed by First Boston and Bankers Trust Co., New York. Goldman, Salomon and Merrill took the first three places in the lease category in 1986.

Total private placement volume stood at $56.7 billion in the first half of 1987, compared with $40.5 billion in the first half of 1986.

Investment bankers seemed respectful of the gains commercial bankers have made in the private placement business during the past few years.

"I think they're in the business, will stay in the business and will emerge as a major competitive force in the business," said Ralph H. Fletcher Jr., a Salomon vice president and head of the firm's private placement group. "You can't ignore them."

But displacing the bulge-bracket Wall Street firms from the top three or four places will be a tough task for commercial banks, both sides agree.

"The sledding gets tougher as you get closer to the top," said Neil H. Powell, managing director and head of private placements at Bankers Trust. "I don't see any reason we won't continue to climb up the league tables. We're getting better but the competition gets tougher. We find we're competing with the best in the business."

Commercial bankers value their private placement business because it is an arena in which they are not restricted by the Glass-Steagall Act, said Robert A. Lawrence, vice president in charge of Citicorp's long-term finance department.

Because private placements allow commercial banks to become identified with an investment banking product, the business has a strategic value if new legislation gives commercial banks a wider franchise in investment banking, he said. "Building successful relationships and market share provides a good fulcrum to lever us into the public markets business."

Commercial bankers have made their greatest strides in placing traditional deals that need to be shown to a relatively small group of investors, said Stephen Newhouse, principal and head of private placements at Morgan Stanley. But their competitive thrust dissipates in transactions in which a wider distribution network is needed, he said.

Commercial bank private placement executives have yet to take full advantage of their banks' contacts with corporate borrowers because of a lack of coordination between the commercial loan operation and the capital markets group, Mr. Newhouse said.

Still, the close contact between borrowers and commercial banks is a plus for private placement officers at commercial banks, both investment bankers and commercial bankers agreed.

"There's a warmer feeling when you walk into that (client's office) than when you're an investment banker and you're walking in cold," said Arthur G. Kearney, managing director and head of private placements at Chase Manhattan Bank. Before joining Chase last year, Mr. Kearney worked with PaineWebber Inc.'s private placement unit for 15 years.

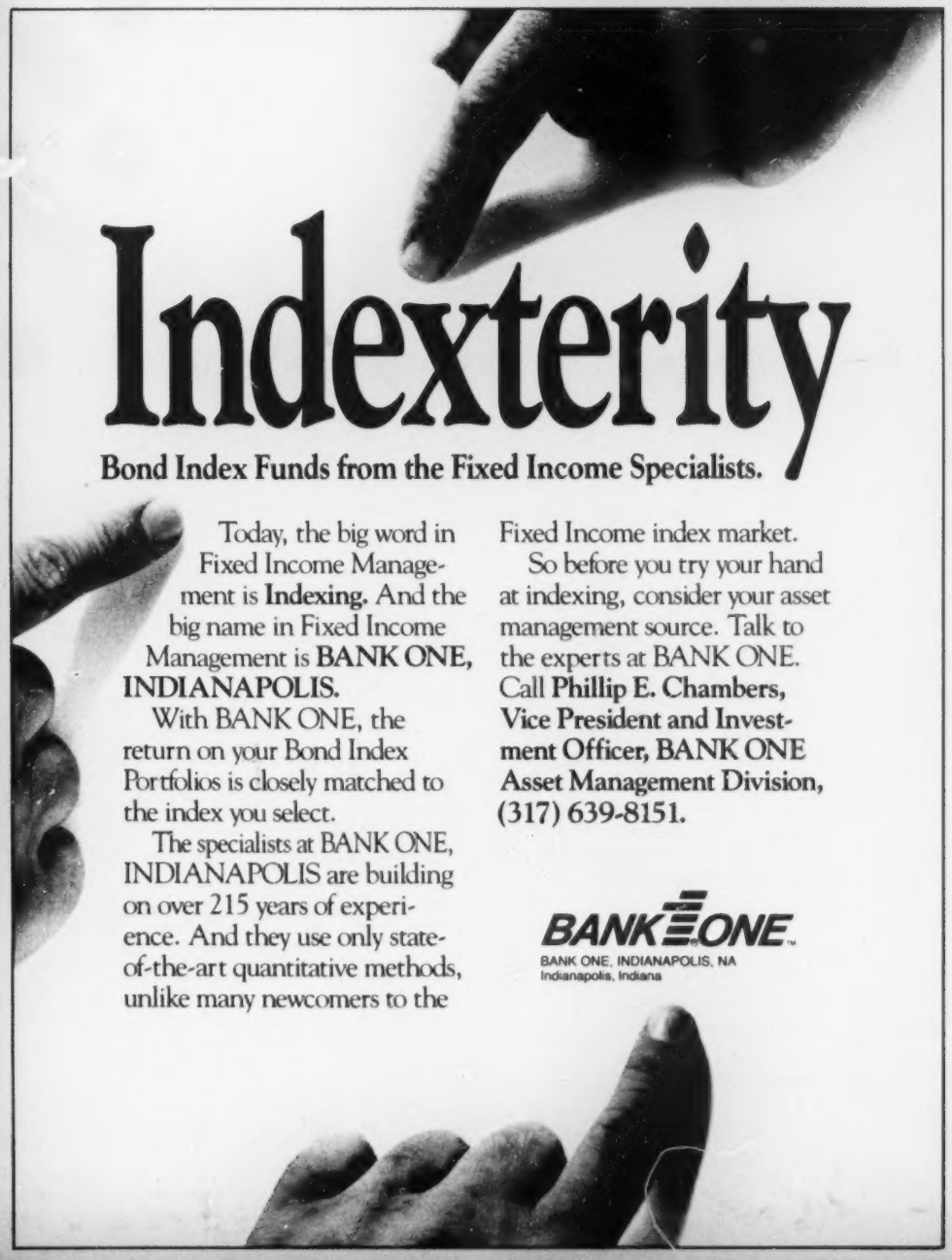
Loan officers at commercial banks are in a position to suggest longer maturity debt for corporate borrowers, who are then referred to the banks' private placement department, said Arthur A. Sharples, managing director and head of private placements at PaineWebber.

Because commercial banks provide a variety of services for corporate clients, bankers see the private placement fee in the context of other client revenue, Mr. Sharples said. "In many cases their (private placement) fees are aggressive." ■

The top 20 private placement rankings
(Equal credit to each manager)

Jan. 1-June 30,1987	($ mils.)	1986	($ mils.)
Goldman, Sachs	6,245.2	Goldman, Sachs	18,623.2
Salomon Brothers	5,227.4	Drexel Burnham	14,740.2
Merrill Lynch	5,184.8	Salomon Brothers	14,560.4
Drexel Burnham	5,000.5	First Boston	14,180.4
First Boston	4,999.2	Merrill Lynch	9,411.2
Bankers Trust	3,737.4	Shearson Lehman	7,139.4
PaineWebber	3,623.3	Citicorp	6,695.8
Morgan Stanley	3,525.7	PaineWebber	5,977.3
Shearson Lehman	3,452	Morgan Guaranty	4,402.4
Citicorp	3,040.5	Bankers Trust	4,311
Morgan Guaranty	2,096.5	Morgan Stanley	3,539.4
First Nat'l Bank of Chicago	1,925.8	Prudential-Bache	2,765.2
Chase Manhattan	1,736.5	First Nat'l Bank of Chicago	2,753.6
Chemical Bank	1,349.6	Chase Manhattan	2,548.8
Prudential-Bache	1,182.9	Kidder Peabody	2,446.6
Kidder Peabody	1,116.6	Bank of America	1,972.7
Security Pacific Nat'l	950.2	E.F. Hutton	1,296.8
E.F. Hutton	786.7	Bear Stearns	1,011.4
Bank of America	664.8	Dean Witter	694.7
Dillon, Reed	339	Lazard Freres	433.3

Source: IDD Information Services, New York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Management firm created in Florida

JACKSONVILLE, Fla. — Florida National Banks of Florida Inc. has created an investment management company to seek fully discretionary clients and emphasize balanced portfolios.

The new unit, Florida Investment Management Co., contracted with the bank's trust department, its only client so far, to run $595 million in tax-exempt assets from eight accounts. John P. Willoughby, FIMC president, said the accounts serve as a seed to get the new company started.

He said FIMC will remain distinct from the trust department and will seek its own clients. The trust department will continue to run about $1.6 billion, excluding the accounts contracted to FIMC.

FIMC expects to start marketing in October, focusing mainly in Florida, said Mr. Willoughby.

"We're not attempting to go national at this point," he said, noting, however, the firm will seek some accounts from other states.

He said FIMC is considering offering performance fee-based accounts, although it isn't now prepared to offer them.

On brokerage, he said FIMC will stress execution, but will use some outside research, paying for it in soft dollars. FIMC has one research professional on staff.

FIMC will run only fully discretionary accounts, and plans to especially seek balanced accounts, Mr. Willoughby said. The unit set $1 million as the account minimum for both tax-exempt and individual clients.

FIMC has four portfolio managers. Two of them, including Mr. Willoughby, who was head of the Florida National's trust investment department, were longtime bank employees. The other two recently joined the trust department in anticipation of moving to the new investment unit, he added.

The four will jointly make investment decisions and policy, he said.

Their style is active, value- and growth-oriented.

He said FIMC plans to limit its clients to a small, still undefined, number to maximize service to each. ■

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For information contact:
Ulla Rodriguez
220 E. 42nd St.
New York, N.Y. 10017
(212) 210-0124

Cash Management

Ratings put kick in Euro-offerings

By Fred Williams

NEW BRUNSWICK, N.J. — One of the primary motivations corporations have for turning to the Eurocommercial paper market — the absence of investor demand for a credit rating — may have lost some of its attractiveness.

Johnson & Johnson's $100 million Eurocommercial paper offering, originated in February, met with slow response. Investor interest picked up only after the company received prime ratings of A-1 and P-1 from Standard & Poor's Corp. and Moody's Investors Service Inc., respectively, when it began a domestic commercial paper program in July, said Andrew Markey, treasurer at the New Brunswick, N.J.-based health-care products company.

He said the company sought the rating because interest rates are better domestically.

The Europaper offering by Johnson & Johnson was the company's first publicly traded debt, said Mr. Markey.

"We had expected a little more interest," he noted. "I don't know whether it was due to market conditions or because we were not rated, but we didn't get as much action in the Euromarket as we had expected.

"The absence of a rating does limit the amount you will sell" in the Europaper market, he added.

"It is true that two or three years ago you didn't need to have a rating, but . . . as time goes on, the discipline and structure of the market is changing and it is now more important to have a rating (to enter the Europaper market)."

Mr. Markey said the response was so slow to the Johnson & Johnson Europaper offering that he put off issuing additional paper. "I would have gone another $100 million," he said.

Johnson & Johnson now has about $1 billion in short-term debt, practically all of it commercial paper, he said.

Johnson & Johnson is working with the commercial paper dealing units of Chase Manhattan Bank and J.P. Morgan & Co.

Johnson & Johnson is not the only company that has found a commercial paper rating valuable to its Euromarket efforts. Brian Clarke, Chicago-based vice president for First Chicago Clearing Center in London, said many U.S. Euromarket issuers are finding ratings helpful.

"We are seeing more and more U.S. companies getting rated before entering the Euromarket. It is becoming a more competitive market and many issuers are not household names," he explained.

"A rating is a quick and easy way for investors to grade an investment — one way to determine the quality of an investment. We are even seeing a little more pressure on non-U.S. issuers to consider ratings," said Mr. Clarke.

"If the investor is given a choice between rated and non-rated paper, he will more than likely take the rated because it does give the investor a basic way to assess

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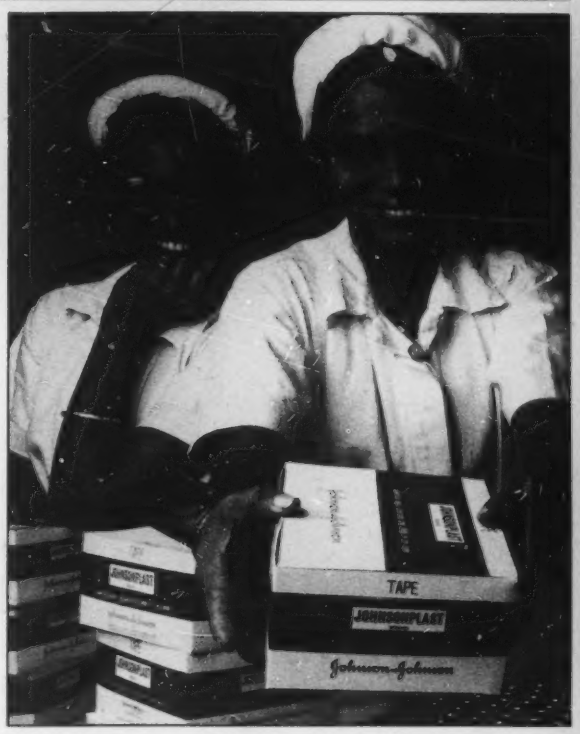


Johnson & Johnson, a health-care products company, saw its Eurocommercial paper offering pick up only after receiving prime ratings for a domestic program.

Scudder, Stevens & Clark corporate cash matrix

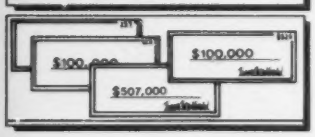
	Yield				Total return			
	August 31		3 mos. ago		1 yr. ago		Latest 3 mos.		Latest 12 mos.	
30-day										
Prime commercial paper/CD/BA*	6.86	4.12	6.75	4.04	5.58	3.01	1.76	1.05	6.50	3.73
Prime tax-exempt commercial paper	7.50	4.50	7.17	4.30	8.57	4.63	1.77	1.06	7.29	4.22
49-day										
Auction-rate preferred stock (AAA-AA-A composite)	7.37	4.40	8.12	4.87	7.73	4.18	1.68	1.12	7.54	4.36
90-day										
Treasury bill	6.37	3.82	5.85	3.51	5.20	2.81	1.54	0.92	5.88	3.38
Prime commercial paper	7.02	4.21	6.84	4.10	5.45	2.94	1.85	1.11	6.24	3.59
Prime tax-exempt commercial paper	7.25	4.35	7.30	4.38	8.50	4.64	1.73	1.05	7.05	4.08
1-year										
Treasury bill	7.06	4.24	7.00	4.20	5.93	3.20	1.30	0.80	4.42	2.54
Prime municipal note	7.67	4.60	7.17	4.30	9.37	5.06	1.37	0.82	7.54	4.36

The matrix is at a constant maturity, meaning all instruments are rolled over monthly. Income is taxed at 40% for 1987 and 46% for 1986; capital gains and loses are taxed at 34% for 1987 and 46% for 1986.
* CD is certificate of deposit; BA is banker's acceptance

pretax
after-tax

ARA looks at banking services

Cash accounts



PHILADELPHIA — ARA Services Inc. bought an account analysis evaluation program from Treasury Strategies Inc., Chicago, to analyze prices and services of 60 banks it uses for cash management, said Susan Hardy, treasury analyst.

"It makes it easier to spot errors and overcharges," she said of the Treasury Strategies product.

She said the company paid $6,000 to $7,000 for it.

The company also looked at an account analysis product of Phoenix Hecht, Northfield, Ill., she said.

ARA had been doing its evaluation manually. It uses 900 banks in all for cash management services.

Analysis adopted

HOUSTON — Houston Industries Inc. contracted with Phoenix Hecht, Northfield, Ill., to evaluate its bank account analysis statements by computer, said Margo Whitt, supervisor-cash management for the energy company.

The company will analyze the statements of 25 to 30 accounts from its major cash management banks: Texas Commerce Bank, First City National Bank, MBank and First RepublicBank Dallas.

She said the computer evaluation will enable Houston Industries to more closely examine individual bank prices and services as well as comparing banks.

"We were looking at it by hand," said Ms. Whitt of the way the company formerly evaluated its account analysis statements.

"We weren't even entering it into a data base."

She noted the company still receives separate statements from RepublicBank and InterFirst Bank, the two predecessor banks that form First RepublicBank. She said First RepublicBank will eventually merge the two accounting systems and send one statement.

The company hasn't used the Phoenix Hecht evaluation much, although it has had it for several months, because of other projects and because the program has been slow when used with spreadsheet analysis, said Ms. Whitt and Rebecca McCulloch, treasury analyst.

They said they expect Phoenix Hecht to improve the program to make it easier and faster to use for spreadsheet analysis and able to accommodate more data.

With the program, the company sends its bank statements

Continued on page 33

Bayer mulls changes in bank set-up

By Barry B. Burr

PITTSBURGH — One of Bayer USA Inc.'s units, Mobay Corp., plans to re-evaluate its lockbox banks as a result of its switch to receive payments electronically instead of by check from General Motors Corp.

Bayer, in a separate evaluation, has bidding under way for several other cash management services provided for its subsidiaries to decide if a restructuring of its bank relationships is necessary.

The services involve cash concentration, wire transfer, payroll controlled disbursement and collection provided to six units — Miles Inc. (formerly Miles Laboratories Inc.) of Elkhart, Ind.; Mobay Corp., Pittsburgh; Deerfield Urethane Inc., Deerfield, Mass.; Haarmann & Reimer Corp., Springfield, N.J.; NRC Inc., Newton, Mass.; and Wyrough & Loser Inc., Trenton, N.J.

Bayer USA, formerly based in New York and called Rhinechem Corp., is a unit of Bayer AG of Leverkusen, West Germany. NRC is a joint venture between Bayer and Hermann C. Starck Berlin KG.

R.W. Heins, treasury analyst, said Bayer USA retained Pittsburgh National Bank to conduct a lockbox study for Mobay. The other cash management evaluations are being done in-house, he added.

He said Mobay, a plastics supplier, recently agreed to receive payments electronically from its major customer, General Motors, based in Detroit and New York.

Mobay hired Pittsburgh National Bank to receive the electronic payments. As a result, General Motors' payments will no longer go to Mellon Bank in Pittsburgh, one of Mobay's lockbox banks.

He said the lockbox study will also look at the possibly of Mobay receiving electronic payments from other vendors, such as those in the chemical industry.

"We do anticipate it (electronic payments from vendors) will be growing, in addition to the GM and the federal government's vendor express programs," he said. The Treasury Department recently announced plans to begin paying vendors to some government departments through the automated clearinghouse.

Mr. Heins expects General Motors to begin the electronic payments to Mobay soon.

Mr. Heins said Mobay decided to use Pittsburgh National, a bank on General Motors' disbursing network for the electronic payments, although Mobay could collect the receipts at any bank.

"If you don't go with a network bank, you're asking for problems," he said.

He said the company looked at other banks on General

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Pension . . .

Continued from page 1

tinue." He estimates net corporate pension contributions fell to $5 billion last year from $48 billion in 1983 and that further growth in surplus could lead to negative net contributions in 1988, that is, when annual benefit payouts exceed cor- porate contributions.

But he notes a major offset to the selling of stocks by sponsors has come from corporations buying back their stock or buying shares in other companies. "Indeed, the boost in corporate profits may accelerate this trend," he states in the report.

The first eight months of this year witnessed two divergent market movements — a dramatic rise in the equity markets and a substantial decline in fixed-income securities' prices — to produce an ideal environment for nurturing pension plan surplus, according to the Salomon report.

In an interview, Martin L. Leibowitz, managing director at Salomon Brothers in New York, calls the huge surplus a "corporate treasure chest."

One investment implication, he said, is that sponsors with huge surplus ratios might seek to reduce their risk tolerance to a very low level to avoid losing the "prize" that already has been won, so the surplus ratio isn't a hostage to market forces as it has been.

Some sponsors might look for an investment strategy to insulate the surplus ratio as much as possible from changes caused by the effects of rising and falling capital markets on pension assets and liabilities. Such strategies might include hedging techniques like surplus insurance or bond portfolio immunization. The authors, although not recommending any investment course, said such a policy depends on a sponsor's tolerance on risking the surplus.

But both studies show the volatility of pension surplus since 1980 and demonstrate how vulnerable the surplus is to capital market movements and can radically change from month to month.

They upset previous research conclusions made by investment banking analysts and pension consultants that corporate pension surplus has grown steadily in this decade as soaring investment returns dramatically increased pension assets.

"The sense of comfort in the stability and growth of funding ratios is unfounded," the Salomon study reports.

Both studies retroactively reexamine corporate pension liabilities under market interest rate assumptions required under the Financial Accounting Standards Board's Statement 87.

Going back to 1980, the studies recalculate accrued pension liabilities using the FASB 87 market interest rates, instead of the more conservative actuarial interest rate assumptions of the Accounting Principal Board's Rule 8.

Their findings show that for most of the years since 1980 the rise in pension liabilities caused by falling interest rates has outpaced the dramatic rise in pension assets caused by exceptional investment returns.

Mr. Leibowitz, along with two Salomon colleagues, Lawrence N. Bader, vice president, and Ardavan Nozari, analyst, re-examined on a FASB 87-equivalent basis the pension liabilities and assets of the Fortune 500 companies. The study accepts asset values as reported by the companies, but adjusts liabilities with market interest rates as the discount factor instead of the non-market actuarial rates used by the group.

Jeremy Gold, principal in the New York office of Morgan Stanley, has a more abstract analysis, although it uses a similar methodology. It computes the changing pension surplus of a fictitious "typical plan," showing only the capital market effects on pension liabilities and assets. To arrive at asset value, Morgan Stanley assumes the typical plan has kept an asset mix of 60% in the Standard & Poor's 500 stock index, 30% in 10-year government bonds and 10% in three-month Treasury bills. Pension liabilities represent those of a typical sponsor, Mr. Gold added.

Both studies show surplus ratios — the market value of pension assets to the discounted value of accrued liabilities — have been highly erratic rather than the smooth growth as perceived.

The aggregate Fortune 500 ratio for year-end 1980, as actually reported by the companies using non-market, pre-FASB interest rate assumptions, was 99%, meaning the pension plans were slightly underfunded.

By contrast, the Salomon study discounted the same liabilities using FASB 87 market interest rates, finding the ratio in 1980 was 186%, meaning the plans actually had nearly double the assets over liabilities.

Morgan Stanley's market-adjusted data puts the 1980 surplus ratio at 157.22% for a typical plan.

"People didn't recognize the (huge surplus) ratio in 1981," Mr. Bader said in an interview.

"FASB is the key issue," said Salomon's Mr. Arnott.

"In the absence of FASB, this (surplus) would have disappeared in a myriad of amortization schedules."

Mr. Leibowitz said the significance of the findings is that the true market value ratio is now visible. In 1980, under the old non-market assumptions, the huge surplus remained hidden. As a result, sponsors were unable to comprehend its significance and accordingly revise their investment objectives and corporate finance activities.

Their objectives had been to protect the pension liabilities when they should protect their surplus, he added.

The studies, however, don't account for any reductions in pension contributions sponsors conceivably might have made in the early 1980s had they reported such huge market-adjusted surpluses.

Despite the growth in assets, the studies show the huge market-adjusted surplus was erratic and declined by year-end 1986. As of the end of December, Salomon put it at 147%, while Morgan Stanley placed it at 132.96%.

But the past eight months witnessed a favorable rebound in the ratio. Salomon put it at 197 as of Sept. 1 and Morgan Stanley, at 167.05 as of Aug. 31.

The surplus ratio shows the extent the market value of pension assets exceed the accrued pension liabilities, discounted at current market interest rates. Mr. Leibowitz said the study didn't examine the liabilities of projected benefits, or those that take into account future service and salary increases because such data weren't disclosed by corporations before FASB 87.

An actuary consultant not involved in either studies, William Partridge, Wyatt Co., Chicago, was less sanguine about the huge surplus ratios, pointing out they show overfunding on a termination basis, not on a projected obligation basis, which considers a plan on an ongoing basis.

"On a termination basis, it's a very healthy plan," one with a ratio above 175%, he said. "But I wouldn't say the game's won."

"You need to understand the industry and particular company and look at (employment) growth prospects," he added.

He agreed, however, that companies with ratios above 175% reach or approach the point of not having to make contributions, though he noted that contributions are based on different actuarial methods than FASB's.

The intent of the studies is to get sponsors to focus on the surplus caused by changes in both pension assets and liabilities, the authors said.

The Salomon data, using Fortune 500 sponsors, takes into account other changes, such as in pension plan design, as well as capital market factors that cause the asset-to-liability ratio to rise and fall.

Mr. Gold noted the Morgan Stanley index identifies only the capital market forces that influence the surplus ratio.

He said Morgan Stanley plans to update its surplus ratio monthly and publish it as the Morgan Stanley Pension Surplus Index. Morgan Stanley set the initial ratio at 125% as of Jan. 1, 1980.

Mr. Gold said the new index will allow a sponsor to compare the performance of its own plan and analyze the reason for any difference.

The Salomon study noted a sponsor with a high ratio — one greater than 175% — has met all the objectives of funding and "has the prospect of not having to contribute to its plan, even allowing modest plan improvements, such as cost-of-living increases for retirees.

"Apart from cashing in on its surplus through a plan termination, the company has little tangible benefit to be gained by further surplus growth. At this point, the sponsor may view the rewards of extending the surplus as minimal (or possibly even negative). The sponsor's risk tolerance may, therefore, drop to an extremely low level, as the goal becomes to avoid losing the prize that has already been won."

The Salomon study projects year-end 1987 ratios, based on the current ratios and various market scenarios. Essentially, it shows that if both S&P 500 and interest rates fall during the next four months, the surplus ratio will erode significantly. If both rise, the ratio will increase accordingly. If the S&P 500 falls but interest rates rise, the ratio could be unaffected, depending on the amount of the market changes. But if the S&P 500 rises and interest rates fall, the ratio could erode somewhat.

Besides the 60-30-10 equity-bond-cash asset mix, the Morgan Stanley index shows the performance of the surplus ratios based on other investment strategies — all equities, all bonds, all cash or all immunized bonds. Those aggressive strategies produced highly erratic ratios as well since 1980.

For example, the Morgan Stanley index 100% invested in equities, since Jan. 1, 1980, would have seen the surplus ratio change from 174.37% at year-end 1980 to 172.42% at 1981, to 150.59% at 1982, to 179.36% at 1983, to 161.06% at 1984, to 155.19% at 1985, to 146.34% at 1986, to 209.65% Aug. 31.

The all-bond and all-cash investment strategies produce similarly erratic ratios, rising to respective highs of 134.81% and 184.8% and ending, respectively, at 115.68% and 103.93% Aug. 31.

The all-immunized strategy showed the ratio stayed at 125%, where it initially was set. ■

Pension surplus ratios

Year-end	Market adjusted: Salomon Brothers[1]	Market adjusted: Morgan Stanley[2]	Pre-FASB 87 Fortune 500[3]
1980	186%	157.22%	99%
1981	235	160.24	111
1982	169	142.32	114
1983	204	161.03	126
1984	199	149.99	133
1985	155	141.58	134
1986	147	132.96	NA
1987[4]	197	167.05	NA

[1]Shows ratios for Fortune 500
[2]Shows ratios for a "typical plan"
[3]As reported by companies using non-market rates
[4]Estimates as of Aug. 31/Sept.1

Source: Salomon Brothers Inc. and Morgan Stanley & Co., New York

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All letters should include name, address and, if appropriate, the company of the writer.

The editors reserve the right to edit any letter for reasons of space or clarity.

Quantitative managers - a comparison

	$ mil.	Commission per share (¢)	Turnover annual (%)	Stocks in portfolio	Performance ended June 30 1987*	1986	1985	5-yr. compound annual
Advanced Investment Mgmt.	175	6-7	101	50	15.2%	51.8%	36.3%	26.5%
Aronson & Fogler	200	2.6	88	250	15	40.4	—	—
Boston Co.	1,500	3	30	75-90	19.2	37.1	37	29.5
Denver Investment Advisors	400	5	125-150	25	11.1	36.6	37.3	29.7
Disciplined Investment Advisors	500	4	60	50	29.9	39.2	32.7	33.2
Franklin Portfolio Associates	1,000	5.3	90	38	25.1	36.9	41.6	37.1
Gradison & Co.	63	9	35	25-40	17.9	45.5	33.5	--
Grantham Mayo Van Otterloo	1,800	X	X	300	21.6	39.3	37.9	—
Harris Trust & Savings Bank	83	7	50	55	19.5	37.1	44.6	—
Matrix Capital Mgmt.	898	3.3	90	115	22.4	42.5	—	—
Mellon Equity Associates	3,100	7	80-100	90	23.8	40.3	38.5	—
Miller Anderson & Sherrerd	1,100	7.4	50-64	110-160	12	38.6	47.4	—
Paribas Asset Mgmt.	400	5	80	60	19.7	39.3	—	—
Rosenberg Institutional Equity	2,300	5	100	225	26.8	43	—	--
Trinity Investment Mgmt.	4,760	5	48	65	25.8	21.5	42.3	30.7
Wedge Capital Mgmt.	263	7	65	32	23.7	46.6	36.7	—
Standard & Poor's 500					25.2	35.9	31	27.9

* for 12 months
X would not disclose information
Source: Data are from the managers for their unhedged, quantitative strategy run for tax-exempt clients and invested in domestic, larger-capitalization stocks.

'Quant' . . .

Continued from page 3

At Xerox Corp., Stamford, Conn., Gerald J. Paolini, manager-trust investment strategy, said, "I would expect quant managers to trade for below average (in terms of cost of commissions per share), because they don't get the benefit of research."

Xerox uses a quantitative approach in investing some of its $2.3 billion in employee benefit assets with outside managers.

Theodore R. Aronson, partner at Aronson & Fogler, agreed with Mr. Paolini.

He reasoned commissions paid per share should be lower for quantitative managers because they are buying a widely diversified portfolio of stocks, whose trading isn't driven by current events.

Stock "picking and trading are all done by machine," he added. "It's usually a machine-to-machine transaction. If that isn't worth some saving, then what are all these cuts on Wall Street?" He was referring to recent personnel cuts at brokerage firms.

Typical equity managers generally pay higher commissions because they seek analysts' opinions, first calls on new issues and other research advantages, he said. "All that has costs attached to it," Mr. Aronson added.

"Aronson & Fogler totally unbundles trading from fees," he added. "We don't do anything for soft dollars."

Daniel J. Schweihs, principal, Disciplined Investment Advisors, said his firm doesn't buy outside research, "so we should have lower commission costs."

He suggested quant managers paying higher-than-average commissions might be paying for marketing assistance or other services.

"I don't think they will do it long term," he added. "Their plan sponsors will require them to lower their commissions."

At Mellon Equity Associates Corp., Pittsburgh, Geoffrey Gerber, senior vice president, said, "We're lucky to have a very good trading desk." He said his firm's trades are pooled with all trades of all Mellon Bank's other investment affiliates, excluding Mellon Capital Management Corp., San Francisco, which runs indexed funds, to reduce costs through economies of scale.

Mr. Aronson suggested sponsors not let the price of commissions override all other investment considerations.

"I don't think sponsors should be uptight if commissions are 8 cents or a dime," he said. "If (total) fees" — trading costs plus investment management fees — "are lower, it all comes out of the same pocket, so what's the difference?"

He noted although his commissions are lower per shares, Aronson & Fogler's investment management fees "are high," 1% of assets run. Even so, he said, Aronson & Fogler's total costs — commissions plus fees — ought to be about as low as those quantitative managers that charge low fees but pay high commissions.

The use of quantitative strategies is relatively new but growing rapidly (*P&I Age*, Sept. 21).

About one-third of the managers surveyed entered the field in the past two years.

Fewer than half have been running money in the strategy for at least five years.

Some of the biggest managers, in terms of assets in the strategy, are among the newest, including Rosenberg Institutional Equity Management, Orinda, Calif., which was started by Barr Rosenberg two years ago and now has $2.3 billion from 19 tax-exempt clients.

Trinity Investment Management Corp., the largest quant manager, with $4.7 billion from 89 tax-exempt clients, is one of the oldest, begun in 1981.

Other data were more difficult to compare. For example, methods for calculating betas, a measure of volatility, varied among managers.

Some calculate their beta on a prospective basis; some run a regression, based on their actual portfolios to arrive at it; and some use historical data. As reported by the managers using varying methods, betas ranged from 0.88 to 1.2. ■

Money movers, a section which details new allocations to managers from tax-exempt funds, appears in each issue of *Pensions & Investment Age*.

Please send information for the money movers section to:

Peter J. Retzbach
P&I Age
740 N. Rush St.
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(312) 649-5390

Reversion . . .

Continued from page 3

Life Insurance Co., New York, and $10 million from Lincoln National Pension Insurance Co., Fort Wayne, Ind. It will purchase more annuities in January.

After reviewing eight or nine competing bids from 15 different insurance companies, Ceco chose "the highest quality companies that offered to do it for the lowest premium," Mr. Rohwedel said.

There will be no changes in pension staff as a result of the termination.

The new plan will be an account-based defined benefit plan in which each employee has an account earning a fixed, guaranteed rate of return. Bank of America Corp., San Francisco, is among the small group of companies using the new type of plan.

"It combines the best worlds of a defined benefit and defined contribution plan. Usually those plans are pretty expensive to provide if the (employee) population is a mature group," said Gary Montesano, a consultant at William M. Mercer-Meidinger-Hansen Inc., New York.

But in the case of Ceco, the plan "will provide some cost savings and it's more flexible and easier to administer" than ordinary defined benefit plans, said Nancy Nasser, manager of corporate pension administration.

The new salaried account-based defined benefit plan will credit to each employee's account 4% of FICA-taxable earnings and 8% in excess earnings of the taxable wage base at the end of each year, Ms. Nasser said. ■

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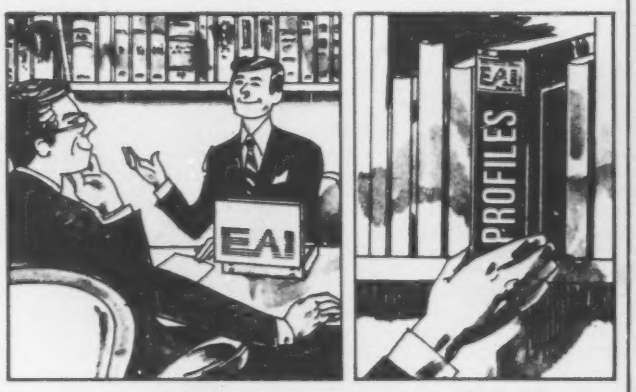

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LDC debt . . .

Continued from page 1

manager with about $130 million in assets, declared: "I'm not sure anyone can make it attractive enough. You can't pay me enough to compensate for the risk. American institutions can't make a case for us that we've made a prudent investment."

Institutional investors view the risk inherent in Third World debt as mind-boggling and very hard to assess.

"It's a different ball game," said Landon Thomas, vice chairman of Fiduciary Trust Co. International, a New York global manager with $17 billion under management. Mr. Landon, who thinks the idea of selling Third World debt to investors has merit, nevertheless, cites the need for a "whole different kind of country analysis."

Institutional investors say they aren't equipped with the expertise or analytical tools to examine and quantify the risk associated with rampant economic and political instability, gyrations in foreign currencies and hard currency availability in a given country, and the potential for default in the developing world.

Many investors also questioned how soon the liquidity of the relatively small market would increase and attract more participants.

"You need people to make markets in these things," said Richard Lindquist, assistant vice president at T Rowe Price Associates.

Investment bankers expect the secondary trading market in less developed countries' bank loans to grow rapidly during the next few years and to begin to attract non-financial institutions.

Today, trading volume is relatively small, at more than $8 billion, compared with the $350 billion potential size of the market, according to Salomon Brothers Inc., New York. Trading is dominated by banks, which use the technique to make portfolio adjustments.

Salomon Brothers predicts trading volume may reach $10 billion to $15 billion face amount by year-end 1987.

Active participants today are about 250 banks and 50 non-financial institutions, up significantly from only 50 banks a few years ago.

Corporate pension fund executives and money managers with fiduciary responsibility for the investments they make on behalf of their companies or clients said they don't consider Third World debt a prudent investment. Managers of pension funds that fall under the Employee Retirement Income Security Act, including corporate pension funds, must meet the "prudent man" rule. "As a fiduciary I have a real problem with this," Mr. Sullivan said.

Leonard Chaikind, administrator of the $5.8 billion pension fund of Shell Oil Co., Houston, said he thinks Third World debt would be too risky for a pension fund. "It wouldn't be a prudent investment," he said.

These investors think it would be hard to make a convincing case for Third World debt to their bosses or the investment committees that oversee investment plans.

Investors also worry there is no way to adequately guarantee countries will make their payments, not default on their payments or unilaterally decide to stop making payments.

Nor do they see Third World debt investments in the same light as straight equity investments in a private-sector business in a particular country. For them, a debt investment is viewed as much riskier than the more common investments in the stocks of companies in developing countries that are traded on foreign stock exchanges. They see Third World debt investments as a big jump from pure equity investments, not necessarily a logical next step in line with the globalization of the market.

Current yields based on Sept. 25 market prices

Country	Price	Yield* (%)
Argentina	39.5	23
Brazil	NA	NA
Chile	57.5	15.8
Colombia	81	11.3
Ecuador	NA	NA
Mexico	47.5	19.2
Peru	NA	NA
Philippines	66.5	13.9
Poland	43	21.2
Romania	87.5	10.4
Venezuela	56.5	16.2
Yugoslavia	66	13.8

* Yields calculated assuming average LIBOR of 8.125% and average spread of 1%, equals a 9.125% current coupon
Source: Shearson Lehman Brothers, N.Y.

"I'm leery of the debt side," said Dan Jacobs, vice president at Templeton International, Fort Lauderdale, Fla., which has about $9.6 billion under management. "We'd rather buy stocks in these countries than debt."

Investors also said current yields, which range from 10% to 23%, aren't high enough to attract them. They agree yields would have to be in the 25% to 30% range to bring them in as buyers.

"The yields haven't gotten to the right level yet," said David Fisher, chairman at Capital International Ltd., a subsidiary of The Capital Group Inc., which manages more than $35 billion. "But they will."

Some investors said there are plenty of solid, lower-risk foreign investment opportunities for them to tap than investing in Third World debt.

And there are other more incidental concerns, including worries that such investments would mean administrative nightmares. For many global investors, investing in foreign equities has meant major administrative headaches. They worry Third World debt investments will mean more of the same.

While most institutional investors will clearly be a hard sell when it comes to buying Third World debt, there are a few exceptions.

"This is the same way people reacted to securitization of the mortgage market a few short years ago," said David G. Bronner, chief executive officer of the $5.4 billion Retirement Systems of Alabama, Montgomery.

"But then the spreads got right and the AAAs came," he said, and the unconverted "started listening."

Mr. Bronner said if Third World debt investments were structured properly, offering protections investors desire such as letters of credit, they eventually will attract investors to the market.

"It'll take time, but we (institutional investors) will one day be an important factor in the market," Mr. Fisher of Capital International said. ■

Bankers hard at work

NEW YORK — Lured by the potential of a largely untapped multibillion-dollar mound of Third World debt, just about every major Wall Street investment bank is working on a way to transform the debt into bonds and other securities that will attract institutional investors.

Drexel Burnham Lambert Inc., Merrill Lynch & Co., Salomon Brothers Inc. and Shearson Lehman Brothers Inc., all of New York, and others are putting lots of time, effort and money into figuring out how to package the loans and sell them to investors in the form of high-yield, high-risk bonds and other securities. A few countries also are promoting their own ideas.

Bankers and developing country finance ministers agree on two things: the effort calls for a new way of thinking about a very old crisis, and institutional investors are not going to take the plunge easily.

"Saying there is broad-scale institutional investor interest in acquiring these assets is whispering in the wind," said Jay H. Newman, senior vice president at Shearson Lehman.

"This is an emerging market. It'll take time. These have to be made attractive to lure them in."

Still, the bankers are confident they can devise various instruments to transform debt into securities in such a way that investor concerns will be eased and they will view the investments as attractive.

"What will make institutional investors buy? Stability in the Third World first and foremost," said John Heimann, vice chairman of capital markets at Merrill Lynch. "The problem won't be solved by innovative financial instruments. It will be by stabilizing payments and building confidence. Then the new instruments will flow and the investors will be there."

In the meantime, Wall Street bankers are trying to adapt standard financing techniques for sovereign debt and develop totally new structures for Third World debt instruments.

Salomon Brothers officials are studying how exchange offers used for corporate restructurings, an as-yet untried technique for restructuring less-developed countries' sovereign debt, might be applied. In exchange offers, existing loans are exchanged for new securities.

Stephen W. Dizard, vice president and senior trader in Salomon Brothers' international loan trading group, said sovereign and corporate exchanges share certain characteristics, although each has distinctive features. He said the characteristics of the less-developed countries' restructuring process indicates this type of refinancing has important but limited applications.

Drexel Burnham Lambert junk-bond king Michael Milken is hard at work on a scheme to securitize Third World debt. Bank debt would be purchased and traded for an equity investment in a solid revenue generator like a hydroelectric plant. Then the equity investment in essence would be used in fashioning an asset-backed security. Revenue from the plant backs the security.

At Shearson, Mr. Newman said the firm is focusing on equity, not debt, by syndicating projects like hotel resorts in Mexico. So far banks have been the main players, but he expects other non-financial institutions to be drawn to the idea later on.

"We think the first investments by institutional investors will be in equity investments, not high-yield instruments," Mr. Newman explained. "With equity deals, you can devise attractive structures and there are plenty of attractive equity investments in countries."

Meantime, teams of Wall Street professionals are working on ways to evaluate, measure and quantify country risk, which would go a long way toward alleviating perhaps the biggest concern of investors.

"It's hard to analyze the risk, but it can be done," said John F.H. Purcell, vice president-corporate bond research at Salomon Brothers.

Mr. Purcell is spending a good deal of time thinking and working on country risk analysis.

"We have to start from scratch. There are some truths about the risk that we can tell," he said. "We can isolate the variables that impact value; we can explain the characteristics of sovereign debt; we can quantify ability to pay."

Also on the drawing board are pools of Third World debt designed to spread the risk that would be somewhat similar to emerging markets growth funds.

Solutions to the Third World debt crisis have surfaced and faded for years on Capitol Hill, in banking and academic circles, and among developing country leaders and experts.

But in recent weeks, spurred by a host of developments on Third World debt, the issue is back at the forefront. The debt crisis and possible solutions were predominant topics at the International Monetary Fund's annual conference in Washington last week.

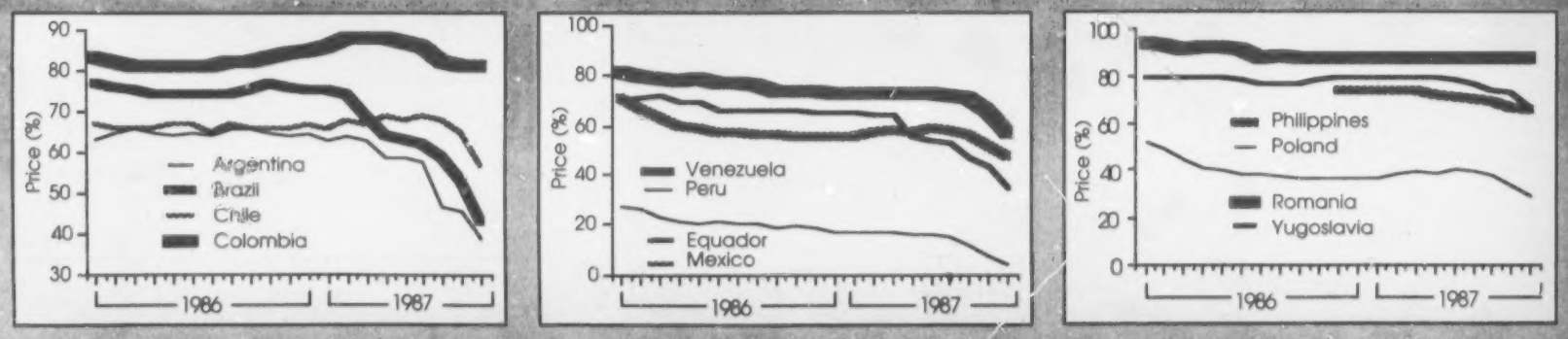
Ever since Citicorp took the bold step this summer of boosting its loan loss reserve by $3 billion and said it would reduce its loans to less developed countries by a third during the next three years through debt-to-equity swaps, attention has turned to the innovative ideas coming from Wall Street and borrowing countries.

Several securitization ideas have been floated by countries. Mexico and Brazil are looking at commodity-linked securities, which could be tied to oil revenue for major producers. Brazil has mentioned performance-related securities. Various countries have cited zero-backed securities. Credit-enhanced instruments, perhaps with a role for the World Bank, also have been suggested.

Debt-equity swaps also are generating some attention from multinational companies that may consider using the swaps as a way to capitalize the operations of overseas affiliates.

— Marcia Parker

Prices of sovereign debt (as a percentage of face value)



Source: Shearson Lehman Brothers Inc., New York

Claim . . .

Continued from page 2
at creating jobs.

The assets under Tower's management included $25 million from the union's individual retirement account plan and $6.5 million for the much larger defined benefit plan, now exceeding $600 million in assets.

The 2nd U.S. Circuit Court of Appeals upheld Sept. 17 a ruling that Tower Asset funneled those assets into 26 companies for which its investment banking parent, Tower Capital Corp., and broker-dealer unit, Tower Securities Inc., were arranging financing. (The firms are not related to Tower Capital Management Inc., Avon, Conn.)

In addition, the three principals of the firms — Andrew A. Levy, Samuel Kovnat and W. Randolph Wheeler — were found to have had equity stakes or controlling interests in some of the companies.

However, the three companies and their principals denied having fiduciary responsibility for the investments, saying they had made some of the investments at the direction of some of the labor trustees. In particular, they argued Mr. Lowen directed the firm to invest in certain projects that would create jobs for union members.

Mr. Lowen's court papers denied those charges, as well as others made by the Labor Department and by plan participants. He declined to comment on the litigation.

Attorneys for Tower and the Labor Department also declined to comment.

But it is all bad news for the Linthicum Heights, Md.-based union, which represents some 10,000 members who work as deck officers on oceangoing vessels, tugboats, barges and other ships.

Like the rest of the merchant marine industry, the Masters, Mates and Pilots union has fallen on hard times. Oceangoing ships under contract have declined to 100 from 340 in 1982 and about 1,000 in 1968, said Mr. Hayes.

Mr. Hayes, who was involved in filing one of two class-action suits against the trustees, claims he was thrown off the retirement plans' board of trustees in June 1985 after he questioned Tower's investment activities. In addition, he won reinstatement to his union post earlier this year after he was discharged for circulating among union members an article on the Labor Department's lawsuit against the trustees and Tower.

Mr. Lowen — who also serves as chairman of the investment committee — with perhaps the help of one or two other union officials, arranged for Tower Asset Management to invest defined contribution plan assets in maritime-industry companies, according to Mr. Hayes, Tower defendants and the Labor Department.

The contract was approved in 1983 by the board of trustees; sources claim management trustees were unaware of the arrangement to focus investments on the maritime industry.

An initial allocation of $15 million of the defined contribution plan was boosted to $25 million before Tower took control of the assets April 14, 1983.

A second contract with Tower, involving some $6.5 million of the defined benefit plan's assets, was executed Nov. 9, 1984, to help finance the "acquisition of seven more ships which the trustees had already determined to acquire in a joint venture" with another individual, Tower defendants allege.

Tower invested a total of $9.15 million in American Heavy Lift Shipping Co., which then bought five tankers and two heavy-lift cargo ships from Gulf Oil Corp.

In June 1985, Mr. Lowen reportedly directed Tower Asset to stop making investments except in government securities or to protect existing holdings, and alerted the Labor Department the firm might have violated ERISA.

The trustees fired Tower Asset Nov. 4, 1985, transferring the assets to 655 Associates, a subsidiary of The Gabelli Group Inc., New York. A Nov. 22, 1985, report to Mr. Lowen from a Gabelli subsidiary cited concern "that a number of the portfolio companies have either gone out of business or are insolvent with substantial current liabilities."

In particular, four companies of which the plans owned 100% of the common stock lacked money to cover their interest payments, the report said. Three of those companies were in the maritime area — including American Heavy Lift — and the fourth was a real estate concern.

In December 1985, the union plan trustees sued the Tower companies and principals, charging them with violations of their fiduciary obligations under ERISA.

However, publicity of the investments led to two class-action suits by plan participants against both the Tower defendants and the plan trustees. The suits later were consolidated.

In February 1987, the U.S. District Court for the Southern District of New York held the Tower defendants had received fees and commissions totaling $1,087,787 or stock interests or both from at least 26 companies in which plan assets were invested. The court ordered the defendants to turn over the fees plus the plans' then-undetermined investment losses.

In March 1987, the Labor Department separately filed suit against the trustees and Tower defendants. In an amended complaint filed in June, the department claimed the trustees did not conduct any independent investigation of the money manager, failed to monitor the investments and did not solicit bids from other investment advisers.

The department further charged Tower had failed to adequately diversify the investments, noting 20% of the defined contribution plan's total assets were invested in risky maritime-related ventures, while virtually the entire $6.5 million pension plan account was invested in such companies.

Echoing charges made by Tower, the department also said Mr. Lowen and trustees Allen Scott and Lloyd Martin directed some of the investments and participated in negotiations concerning the investments.

The Labor Department alleged that as of Tower's termination, the value of the defined contribution plan account was down to $7.7 million from $25 million, while the pension plan account had shrunk to $1.8 million from $6.5 million.

In a strongly worded decision, the appellate court held Tower defendants could not avoid fiduciary responsibility: "Under ERISA, an investment manager's fiduciary obligations may not be turned on and off like running water."

Five days later, a federal magistrate concluded the plans had incurred damages of $34.2 million in lost principal and income stemming from Tower's management. Some of the assets, however, have appreciated substantially since Tower was fired.

First Boston . . .

Continued from page 3
the bond market slump, which kept some issuers on the sidelines. The bond market's lack of direction proved to be vexing to issuers, said Robert G. Scott, a managing director at Morgan Stanley & Co.

"The market was difficult in that it was dominated by technical considerations like the dollar and the trade balance," Mr. Scott said.

"We had many weeks during the third quarter when the market was very focused on a particular technical situation like the trade deficit and in many cases these announcements turned out to be inconclusive and just didn't provide direction to the market."

Drexel Burnham Lambert Inc., jumped to fifth place overall after ranking seventh in the second quarter.

Drexel made its gain despite speculation about a federal inquiry into some of the firm's dealings.

"As time goes on, it's less of an issue in terms of soliciting business," said Gerald L. Brodsky, a managing director at Drexel.

The firm's ranking among bulge-bracket firms resulted in part from the $1.5 billion high-yield debt deal for E-II Holdings, a newly formed company that operates businesses formerly owned by BCI Holding Corp.

PaineWebber Inc. made the biggest move in the overall rankings, catapulting to 10th after placing 20th in the second quarter.

Jack Perkowski, PaineWebber's director of investment banking, played down the jump, saying 20th place was an aberration for the firm.

The firm's third-quarter decision to start underwriting closed-end funds accounted for some of its rise in the tables, Mr. Perkowski said.

A $1.26 billion high-yield debt offering for Harcourt Brace Jovanovich Inc. helped put First Boston in the top spot.

"It was kind of our turn to come to the party," said Robert L. Cooney, a managing director. "We have continued to penetrate new sections of both the equity and high-yield markets."

He attributed some the firm's strong third-quarter showing to its merchant banking activities.

In the HBJ recapitalization, First Boston provided a $901 million bridge loan that was repaid with part of the Sept. 18 high-yield debt offering.

Merchant banking, in which investment banks make short-term loans to speed completion of a buy-out, also contributed to heavy volume at Merrill Lynch Capital Markets, which was sole manager of a $1 billion debt transaction for Borg-Warner Holdings Corp. and a $700 million deal for Supermarkets General Holdings Corp.

"Those financings are a reflection of our success in proposing leveraged buy-outs and then refinancing the bridge loans," said Barry S. Friedberg, director of investment banking at Merrill.

Acknowledging the risks involved in merchant banking, he said careful management and sound credit analysis are "what the control and measurement of risk is all about. We feel comfortable with what we are doing."

Merrill Lynch's role as the book manager in the $1.2 billion Citicorp equity offering — the biggest sale of stock in the quarter — also ensured its position among the bulge-bracket firms.

A merchant banking relationship in the buy-out of Burlington Industries Inc. helped Morgan Stanley & Co. become the sole manager in the $1.3 billion sale to the public of Burlington Holdings Inc. high-yield debt Sept. 23. Burlington Holdings also sold $384 million of debt to The Equitable Life Assurance Society of the United States.

"One of the things you notice when you look at the quarter is there was a lot of high-yield financing," said Morgan's Mr. Scott. "A lot of that financing was in the pipeline, basically associated with transactions earlier in the year."

The underwriting business looks strong for the fourth quarter, he added.

"More and more economists and market strategists are becoming pretty negative about the prospects for rates in 1988 and we are beginning to have conversations with issuers about pre-funding their 1988 requirements now. That could result in pretty substantial additional volume in the fourth quarter," he said.

Drexel officials expect a busy fourth quarter in the high-yield business, Mr. Brodsky said. "We see a tremendous inventory and volume that has to get done before the end of the year."

Much of the the fourth-quarter volume depends on the markets, Mr. Friedberg noted.

"Our fourth-quarter volume could be better than our third-quarter volume if the markets will let us get all the business off that we have in front of us." ■

Bottom line . . .

Continued from page 1
tween 110% of termination liability and 150%, but once those liabilities and assets start to move around, it's going to be difficult for companies to maintain that level," said Richard Raskin, consulting actuary with The Wyatt Co., New York.

For some companies this will mean slower funding — at least at first.

"Companies with a lot of assets won't be hurt right away because they aren't going to contribute anything," Mr. Raskin said. "But at some point they are going to have to pay the piper."

The bill's provision, which would raise $3.9 billion during the next three fiscal years, is the most likely from among a list of revenue-raising options in the pensions area expected to be taken up the Ways and Means Committee this week.

The panel already has signaled its disapproval of employers using pension plans as a tax shelter. Earlier this year it approved a proposal doubling the 10% tax on reversions of excess pension funds to 20%. This adds to the probability the measure will be taken up.

Observers expect the Senate Finance Committee to hold off taking action on any similar pension proposal.

"The Finance Committee doesn't want to play 'Profiles in Courage' until they see what Ways and Means is going to do," said Stuart Brahs, executive director of the Association of Private Pension and Welfare Plans, Washington.

The Ways and Means Committee met behind closed doors Oct. 1, but did not vote on any proposals because of disagreements between Democratic and Republican members. At press time, the committee still was scheduled to reconvene on Oct. 7.

Both the House Ways and Means and Senate Finance committees are looking at a list of more than 200 revenue-raising options suggested by the Ways and Means and Joint Committee on Taxation earlier this year (*Pensions & Investment Age*, July 13).

The full-funding limit is considered vulnerable because it would raise $600 million in 1988 and $3.9 billion during the next three years and hasn't been as vociferously opposed as other options, according to sources on Capitol Hill and within the administration.

The measure is being opposed by the APPWP, which warned Ways and Means Chairman Dan Rostenkowski, D-Ill., in a Sept. 29 letter that "it is counterproductive to make arbitrary changes in limits for well-funded plans that could have a negative impact on their long-term financial security."

Companies with new pension plans and young work forces could be hit particularly hard by this change. Employers, in order to avoid being taxed, would inadequately fund their plans during the early years and would be forced to back fund as their work force grows older.

There could be problems in later years when the employer must contribute a much larger amount if for some reason it can't afford those payments.

Another disadvantage is the money wouldn't be there early to collect investment income.

"This increases employer real costs as well as shifting more of the costs to future years," not to mention further discouraging the establishment of defined benefit pension plans, according to APPWP's letter.

Last week, the Ways and Means Committee had been expected to close the loophole in the Tax Reform Act of 1986 that allowed an estate to exclude from taxation 50% of the sales of the stock of an ESOP. This option, which is not controversial even to the Employee Stock Ownership Plan Association, is still seen as a shoo-in.

This change would generate $1.3 billion in fiscal 1988 and $4.8 billion in the next three fiscal years.

Other options previously listed by the tax committee staff affecting pension funds and ESOPs, including a possible 5% tax on investment income of pension trusts and other tax-exempt organizations, are still on the table, but aren't seen as being in grave danger of making it into the budget reconciliation bill. ■

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Ulla Rodriguez
220 E. 42nd St.
New York, N.Y. 10017
(212) 210-0124